Transnationals

NO CONSENSUS ON CODE OF CONDUCT

Fresh Approach for Global Standards for Foreign Direct Investment Recommended

The intergovernmental group convened to finalize the United Nations Code of Conduct on Transnational Corporations recommended alternative methods to encourage global foreign direct investment and strengthen the host country-investor relationship.

"It was the view of delegations that no consensus was possible on the draft Code at present", reported Samir Shihabi, President of the General Assembly. "Delegations felt that the changed international economic environment and the importance attached to encouraging foreign investment required a fresh approach." If the General Assembly agrees, the thirteen-year effort to conclude the United Nations Code will be put aside.

Though both developed and developing countries agree on the need for an instrument to govern global foreign direct investment, they differ on its level of detail and legal "bite". Begun in the 1970s, a period marked by a distrust of transnational companies, the Code is seen by many countries as being too regulatory of foreign investors—although the level of regulation is left to the sovereign discretion of each country.

The draft Code lays out the rights and obligations of both corporations and governments. The major part of it has been accepted by all countries. Western countries feel, however, that it does not provide enough safeguards for investors. Though no expropriation has occurred in the last fifteen years, business remains uneasy.

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A Code History

1976	UN Commission on TNCs undertakes the preparation of an international code on foreign direct investment.
1977	Drafting begins. Originally, the Code is to cover only transnational corporations' behaviour.
1980	Code is expanded to cover governmental behaviour.
1982	First draft is submitted to the Commission for negotiation.
1988, 1990	Work continues on the draft in order to reach consensus among all countries.
1991	Commission forwards draft to the Economic and Social Council, and then to the General Assembly, for action.
1992	General Assembly group suggests finding an alternative to the Code.

Small-Scale Enterprises to Fuel Zimbabwe Reform

In implementing its new programme of radical economic reform, Zimbabwe is giving much weight to small-scale enterprise. A just-launched TCMD-UNDP programme of enterprise development will help start-up entrepreneurial enterprises to step up exports, acquire innovative new technologies and create jobs through link-ups with transnational companies.

Estimates place the number of small-scale enterprises in Zimbabwe at 845,000. Most are in construction, textiles, horticulture, agribusiness and retail activities and produce primarily for the domestic market. Small firms employ 1.6 million people, almost twice as many as the formal sector. Requiring little start-up capital, they generate more jobs per dollar than large firms. And, despite their size, small enterprises often develop into dynamic and technologically sophisticated companies.

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Guidelines in Lieu of Codes

At the same time, the increasing globalization of the world economy increases the need for an international framework for foreign direct investment. "In speaking with government officials in Tokyo, Bonn and London", said Allen Asher of the Australian Foreign Ministry, "I found a real receptiveness to a new approach which sets aside the existing text of the Code and instead opts for a guideline of ethical business practices . . . dealing with issues such as environmental protection, consumer protection, restrictive business practices, financial behaviour and the treatment of global businesses."

Government officials receptive to a new approach opting for a guideline of ethical business practices.

But many fear that guidelines will not have the same impact as an international code. To allay their apprehensions, supporters cite the success of the 1985 United Nations Consumer Protection Guidelines. Completely voluntary, those guidelines are being used by government and business throughout the world to set consumer protection standards.

The OECD already has a set of guidelines on foreign direct investment. Some observers argue that it should be strengthened. An international investment code might, they say, be most effective if drawn up by the world's largest home and host countries—the United States, the European Community nations and Japan, which account for 80

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Zimbabwe

(Continued from page 1)

"Small- and medium-sized enterprises", said Bernard Chidzero, Minister of Finance, "are potentially large-scale enterprises. They and larger companies, domestic or multinational, should be complementary elements in an integrated growth process, both nationally and regionally".

Promoting Foreign Links

Transnational corporations, particularly, British, South African, American and European firms, have for decades played a key role in Zimbabwe's economy. Transnational firms account for about half of all investment in manufacturing. Over the 1990s, the number of new investment proposals has surged. Union Carbide, for instance, wants to expand operations. Mobil Oil would like to explore for oil. BHP-Utah and Delta Gold N.L. from Australia are finalizing the details of a platinum-mining project. And Anglo-American is investing in promising entrepreneurial ventures in the manufacturing sector.

New investments tend to take the form of joint ventures, either with government or local enterprise. There are numerous possibilities for link-ups between foreign firms and smaller local ones, particularly in subcontracting and licensing. To take one example, Zimbabwe is currently experiencing a tourism boom, and opportunities for partnerships in advertising, construction and interior decorating are rife. Similarly, foreign firms are interested in parcelling out production of electronic parts.

The TCMD-UNDP programme —EMPRETEC Zimbabwe—will focus on building technologically innovative, small-scale firms, and fostering their links with transnational companies and entrepreneurs in neighbouring countries. The programme aims to train over 800 entrepreneurs in the next three years, setting up 150 new enterprises and creating upward of 4,000 jobs.

Bernard Chidzero, Zimbabwean Minister of Finance, awards a certificate to one of the first entrepreneurs trained by EMPRETEC Zimbabwe. Looking on is Ariston Chambati, CEO of TA Holdings.

EMPRETEC Zimbabwe

Launched in July 1992, the EMPRETEC programme has six stages: entrepreneurship training; project formulation; enterprise development; transnational corporations linkages; cross-border joint-venture promotion; governmental and private-sector institution building.

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EMPRETEC Zimbabwe will train over 800 entrepreneurs in the next three years, setting up 150 new enterprises.

International Competitiveness: The Trade-Foreign Direct Investment Link

Investors seeking low-cost labour should gravitate to developing countries, but concentrate instead in more developed, higher-wage economies. The reason, suggests a forthcoming study by Professor Louka Katseli of the University of Athens—*Foreign Direct Investment and Trade Interlinkages in the 1990s: Experience and Prospects of Developing Countries*—is "thick-market externalities".

The concentration of firms and economic activity in more industrialized countries is creating integrated "internal" markets, where business and producer services are easily available. As a result, the real effective cost of doing business is lowered and the expected profitability of investments rises. The absence of "thick-market externalities" in developing countries undercuts the cost advantages offered by low-wage labour and discourages foreign investors.

Developing countries successful in attracting investments have used export earnings to build infrastructure and local technological capacity.

The presence or absence of such "thick-market externalities" is particularly significant in influencing high-tech assembly transplanting and component outsourcing investments.

To promote investment, the study prescribes that developing countries should focus more broadly on reducing effective operating costs by building an efficient operating environment. With manufacturing becoming more high-tech, a host country's "business culture", its human and economic infrastructure and its tax system have become central elements in the calculus of investment returns. More and more, production costs encompass other expenses such as telecommunications, the availability of business services, work organization, labour training, and the quality of local administration. Governments should give priority to modernizing infrastructure and improving education, training and health.

Evolving Investment and Regionalization

Among developing countries, the most successful in attracting and sustaining foreign investments are those that have used export earnings to build infrastructure and local technological capacity. Initially most investments were resource- or labour-seeking. As exports grew, host country incomes rose. National infrastructure and labour skills were upgraded. The wage rate increased. Capital-intensive, technologically advanced investments began to replace earlier resource- or labour-seeking ones.

As countries evolve up this foreign investment ladder, labour-intensive, export-oriented activities relocate to neighbouring low-wage countries—in what economists term "flying-geese formation". The original host often becomes a prime investor in the new country. An integrated division of labour emerges in the region, with the richer, higher-wage countries housing the more technologically advanced industries and the lower-wage ones

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FDI—Trade Interlinkages

Type of investment	Trade effect
Labour-seeking: concentrate in	
(1) **manufacturing** (e.g. electronics, automobiles)	Increased manufactures exports
(2) **component-outsourcing** (e.g. subcontracting and high-tech assembly)	Increased exports of final or semi-final goods, mainly through intra-firm trade
Market seeking: target host-country consumers and produce brand name products (e.g. pharmaceuticals)	Import substitution. May also increase exports of manufactures.
Resource-seeking: concentrate in mineral extraction and agriculture	Primary products exports Equipment imports
Services: drawn by potential client firms, they concentrate in banking, transportation and business services	Increased economic competitiveness even if there is no immediate boost to manufactures exports

READER FICHE

Making Taxes Attractive to Foreign Investors in Eastern Europe

In establishing new foreign direct investment regimes, Eastern and Central European governments are seeking to make their tax systems attractive to foreign capital. Key United States and Canadian investors offered them some valuable tips at an international symposium at United Nations headquarters on 10 and 11 June 1992.

Tax experts and senior executives from firms with potentially major projects in the region—among them Citibank, Colgate-Polmolive, General Electric, General Motors, Hewlett-Packard, ITT, Merck and Ernst and Young—met with the national tax authorities of the Czech and Slovak Federal Republic, Hungary, Kazakhstan, Poland, Russia and Ukraine.

Improvements include: reduced withholding taxes and tax deductions for wages, research and development expenses.

They shortlisted areas where improvements might be helpful and suggested that those countries where wages and research and development expenses are not tax-deductible should consider making them so as soon as possible. They also suggested that withholding taxes on the repatriation of profits be reduced or even abolished; that effective tax rates be made consistent with the corporate and individual rates of their trading partners in other regions by being harmonized with international standards; that consolidated returns and losses be allowed; and that rules for thin capitalization be considered. Governments might offer further tax incentives for targeted businesses.

In short, corporate participants highlighted changes that would catch the eye of the chief executive officers of potential investors. "It is helpful", said Ed Saperstein, partner, Ernst and Young, "if the tax system is straightforward and readily understandable." All agreed that perhaps more important than tax incentives is a tax system that is stable, reliable, simple and transparent.

Tax Incentives or Not?

The Central and Eastern European countries differ in their treatment of foreign investors. Poland, for instance, has no special incentives for foreign capital besides an investment tax credit, which lapses at the end of 1993. In contrast, Hungary grants foreign

Ed Saperstein, Partner, Ernst and Young.

Tax Rates on Foreign Investments

	Kazakhstan	Russia	Ukraine	Czechoslovakia	Hungary	Poland
Tax holidays	Up to 10 years	None	Up to 5 years	Rare	Partial 10-year holiday	Tax credit or partial relief
Corporate income tax	30%	32%	18%	45% (as of 1993)	40%	40%
Withholding tax on						
(a) interest	15%	15%	18%	25%	0	20%
(b) dividends	15%	15%	15%	25%	0	20%
(c) royalties (with no treaty)	20%	15%	15%	25%	0	20%

Alan Wilensky, Deputy Assistant Secretary (Tax Policy), United States Department of Treasury.

firms a partial 10-year tax holiday for certain investments made before 1993.

"There is no question that tax holidays can be significant in investment decisions", said Peter Barnes of the General Electric Company. Along with General Motors, GE was the first US company to make a major investment in the Eastern bloc. Its tungsten manufacturing facility in Hungary produces lightbulbs that are sold throughout the region.

Incentives will not necessarily spark foreign investment unless governments look at the total tax package.

"But it is important to keep tax holidays in perspective." Typically, he said, they apply only to corporate taxes or net profits. There are other taxes that, at least in the initial years, can be far more important, namely, withholding taxes on interest and royalties, VAT taxes and the treatment of taxes on foreign employees. Some countries seem to focus exclusively on tax holidays as the means to attract foreign investment, while they retain high withholding taxes or other tax barriers. Incentives will not necessarily spark foreign investment unless governments look at the totality of the tax package.

Ed Saperstein added, "If you are giving foreign firms a benefit, one that increases the earnings of a company is much better than one that just increases the cash flow".

Participants urged that wages should be tax-deductible. In

Alexander Pochinok, Chairman, Committee of Taxation, Budget and Pricing of the Russian Supreme Soviet.

Russia, they are not. Alexander Pochinok, Chairman of the Commission on Taxation, Budget and Pricing of the Russian Parliament, explained: "Our current priority is to limit inflation. With 96 per cent of all enterprises still state-owned, we are compelled to keep a strict limitation on wages. As soon as private-sector enterprises begin to play a considerable role in our economy, we will give up certain restrictions linked to the payment of wages".

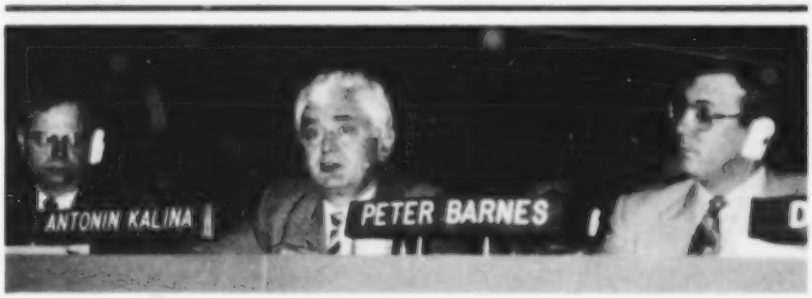
"The aspects in our tax system that you see as obstacles are directed primarily towards intermediary companies which resell raw materials. Given the price differences between our country and the rest of the world in primary commodities, this kind of activity is extremely lucrative for middlemen. We have, therefore, been applying restrictions. But for serious investors, taxation will not be an obstacle." Since most Russian taxes are levied only at the end of the year, investors may, in fact, benefit from the current inflationary tendencies, he remarked.

Do Tax Criteria Match?

Another make-or-break issue for United States firms is whether the income or tax base determined under local rules matches that determined by the home country. Varying definitions can result in double taxation.

In many of these countries, tax systems are being put together for the first time. The problem, said Alexander Pochinok, is "to construct something specific to their own situation, while trying at the same time to ensure that taxes do

(Continued on page 6)



(from right to left) Peter Barnes, General Electric, Antonin Kalina, Head of Tax Administration, Czech and Slovak Federal Republic and Roger Wheeler, Chief Tax Officer, General Motors.

Tax Symposium

(Continued from page 5)

not impede any serious foreign investor".

The establishment of appropriate guarantees to protect foreign investors was discussed, as well as currency convertibility and transferability matters. Participants urged the speedy adoption of complete convertibility and the loosening of restrictions on dividend repatriation.

A Regional Tax Treaty Network

The Eastern and Central European states need to "organize and re-establish the rules" for trade, foreign direct investment and taxation, explained Szabolcs Vamosi-Nagy, head of the main department of the Prime Minister's tax office, Hungary. In the absence of new agreements, the accords of the now-defunct COMECON are still the principal operating guidelines. Corporate participants agreed. A network of new or renegotiated double-taxation agreements between the countries of Eastern and Central Europe and their trading partners in other regions might go a long way in encouraging investment.

The symposium, "Taxation of Foreign Investment in Central and Eastern Europe", is part of an extensive TCMD programme of technical assistance in foreign direct investment promotion, enterprise and entrepreneurship development, accounting training and legislative development in Central and Eastern Europe. Background papers and a transcript of the symposium will be published soon. Funded entirely by the Washington-based Tax Executives Institute, it was possibly the first occasion when the United States private sector had used the United Nations as a forum to meet with the governments of Central and Eastern Europe to discuss business. ■

Accounting in the New Independent States

Accounting reform is moving in tandem with tax reform in the Commonwealth of Independent States. Russia last December adopted a new chart of accounts that legislated market accounting into national use and did away with socialist bookkeeping. Belarus and Moldova have followed suit and other states in the Commonwealth are now considering the revised chart.

The Ukrainian Ministry of Finance, the OECD and TCMD hosted an international conference on Accounting Reform in the New Independent States, Kiev, 14-15 July 1992. The eight new states—Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Turkmenistan, Ukraine and Uzbekistan — represented by officials at the highest level, met with international experts, accountants and investors and sought their guidance in charting change.

Accounting will have to deal with problems difficult even in market economies: inflation, asset valuation, and the relationship between financial and tax accounting.

These former centrally-planned economies are looking to develop a system of accounting which measures financial performance at the enterprise level. Modernized accounting is also essential for attracting foreign capital. Foreign investors desire reliable enterprise information to make investment decisions, especially in cases of privatization. At present, a variety of different account practices prevail in Europe and North America. Depending on the national standard, a firm's income may vary by as much as twenty-five times, a recent accounting journal shows.

Some Western countries, however, have urged the New Independent States to adopt their national accounting systems, offering attractive financial and technical assistance packages to set these up. Conference participants warned against the adoption of any one national set of standards, arguing rather for international ones. Widening the range of economic partners is a key objective of accounting reform in the Commonwealth. National standards might facilitate relations with one partner while impeding them with others.

Regional Coordinating Council

In shifting to a market system, accounting will have to deal with several thorny problems which pose difficulties even in market economies. Among them are inflation and the valuation of state enterprises slated for privatization. The relationship between financial and tax accounting will need to be clarified.

Change should be gradual, building on existing human and institutional capacity. "I am not an advocate of 'shock therapy'," said Lorraine Ruffing, head of TCMD's accountancy development programme. "It risks destroying the building blocks from which an adequate accounting system can be produced. We do not need a revolution to produce useful accounting information."

The Conference set up a Coordinating Council to devise suitable accounting systems for the eight new states and oversee their implementation. The Council will exchange information and experience on accounting reform,

including bilateral and multilateral technical assistance. It will promote the development of the accountancy profession and of accounting research and training. Most importantly, it will help the harmonization of accounting standards throughout the region. "The recommendations of the Coordinating Council", announced the eight new states in a joint resolution, "will be used when formulating national accounting standards".

TCMD, the OECD, the European Commission and the World Bank will jointly support the Council in its work. They will, moreover, assist the new states in developing the appropriate institutional structures for accounting reforms. ■

Code of Conduct

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per cent of all foreign direct investment.

The United Nations Commission on Transnational Corporations, charged with drafting the Code of Conduct, will now focus on developing new guidelines or activities by which to set basic standards of behaviour in the foreign direct investment relationship. The World Bank is preparing a similar set of guidelines, based largely on the network of bilateral treaties for the promotion and protection of foreign direct investment. But the latter focus on the behaviour of governments, not companies. They will need to be supplemented by an instrument covering the behaviour of foreign investors.

The Commission concluded its work on the draft Code of Conduct last year. The draft was then sent to the Economic and Social Council and the General Assembly for adoption. No agreement could be reached. The President of the General Assembly convened an intergovernmental group headed by Farooq Sobhan, a Bangladeshi diplomat and chairman of the 1992 session of the Commission, to suggest further action. ■

Zimbabwe

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The programme is being implemented in close collaboration with the Zimbabwe Investment Centre and an Advisory Board that includes the Chief Executives of TA Holdings and Anglo-American, the Governor of the Reserve Bank, executives from the Confederation of Zimbabwe Industries, the Zimbabwe Development Bank, the Indigenous Business Development Centre and the Ministry of Industry. The Board will play a key role in harnessing the managerial and technical expertise of the local business community to support small- and medium-scale enterprise development in Zimbabwe.

EMPRETEC Zimbabwe is cooperating with other small-scale enterprise programmes managed by UNDP, ILO, UNIDO, USAID, CIDA and the European Community. ■

Competitiveness

(Continued from page 3)

taking over more basic manufacturing activities.

Such a pattern is visible in South-East Asia, with Japan originally investing in Hong Kong, Taiwan, Korea and Singapore, and those countries now investing in Malaysia, Indonesia and Thailand. Singapore, moving away from labour-intensive manufacturing, has built itself up as a regional services centre. The Republic of Korea has developed into a base for complex manufacturing activities.

Latin America, in contrast, manifests no such regionalization. Here trade and foreign direct investment links remain limited to the original home and host countries. Large domestic markets could be the reason, the study says. Foreign investment has been primarily in final products targeting the local consumer. In Mexico, however, new governmental trade and economic policies are attracting much capital in the high-tech and services sectors.

With little reinvestment in technological upgrading, even large local markets are not sufficient to attract manufacturing investments.

Nigeria, a big oil producer, receives almost a half of all foreign direct investment in Africa. But investments have not evolved upward and continue to concentrate in oil-extraction activities. With little reinvestment in technological upgrading, even a local market of more than 100 million has not been sufficient to attract foreign capital into manufacturing activities.

Attracting High-Tech Investment

Countries without a basic quantum of foreign direct investment could use networking policies to compensate for the absence of "thick-market externalities". Information exchange or subcontracting arrangements would link domestic firms and help them tap into regional or international trading networks. Finally, clear investment rules and stable macroeconomic and credit policies would reduce uncertainty for the investor. ■

The First Transnationals

Transnational companies are not, as many believe, an American invention. Neither are they a post-Second World War phenomenon.

A soon-to-be released anthology —*Transnational Corporations: A Historical Perspective*—details the emergence and evolution of the transnational company and includes a lively account of some of the first firms to establish operations overseas.

A Varied Constellation of Firms

In 1830 the British set up the first global banks, with operations in Australia, Canada and the West Indies. The first British manufacturing transnationals were set up about 1880. By 1914, firms such as Lever Brothers, J and P Coats, Dunlop and the Gramophone Company had operations spread all over Europe, the United States and the Empire.

Germany had the most extensive pre-1914 network of transnational corporations, run by such electrical and chemical firms as Siemens, Bosch, Hoechst and Bayer.

The first American transnational was Singer, which set up a sewing machine factory in Glasgow in 1867. By 1914, there were over forty United States companies with factories overseas, particularly in the machinery and food sectors. By 1929, ITT was employing 95,000 people outside the United States, in Spain and Latin America, and Pan AM had gone transnational.

The early Japanese transnationals were primarily trading firms. Backed by the government, they spearheaded Japan's re-entry into the world economy, following more than two centuries of political and economic isolation. The first of these firms—Mitsui Bussan—was established in 1876. By 1900 it handled around one third of Japan's total foreign trade, with nearly forty branches in Asia and Europe.

Contrasting Strategies

In contrast to United States firms investing abroad, European transnationals were generally small and medium-sized firms.

Corporate forms differed. "Free standing" companies, very popular with the British, were small overseas head offices specifically formed to manage financially a single foreign investment. "Migrating" transnationals gradually moved their assets from home to host country, where most activities took place. One example is ANZ, the British bank that relocated to Australia. ■

Some Early Transnationals

Germany	United States	United Kingdom	Japan
Siemens	Singer	Lever Brothers	Mitsui
Bosch	Coca-Cola	J and P Coats	Kikkoman
Hoechst	Gillette	Dunlop	Mitsubishi

Transnational Corporations: A Historic Perspective, edited by Geoffrey Jones, is the second in a twenty-volume *United Nations Library on Transnational Corporations* being prepared by TCMD. It will be released together with Volume 1: *The Theory of Transnational Corporations*, edited by John Dunning; Volume 3: *Transnational Corporations and Economic Development*, edited by Sanjaya Lall; and Volume 4: *Transnational Corporations and Business Strategy*, edited by Donald Lecraw and Allen J. Morrison.

Published by Routledge, London.

The Transnational Corporations and Management Division is one of eight Divisions in the United Nations Department of Economic and Social Development. Under the guidance of the Commission on Transnational Corporations, an intergovernmental subsidiary organ of the United Nations Economic and Social Council, TCMD seeks to further understanding of the nature of transnational corporations; to secure effective international agreements; and to strengthen the negotiating capacity of host countries, in particular the developing countries.

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